



Fraud Report 2009

A survey into fraud and financial risk management
Southern England

The threat of Fraud to recessionary UK

Fraud is a major risk to the survival of businesses in any adverse economic climate.

As 'UK plc' battles against the worst recession for a generation or more, this Fraud and Risk Management survey provides an extremely pertinent and timely report on the readiness and ability of businesses to combat the threat of fraud.

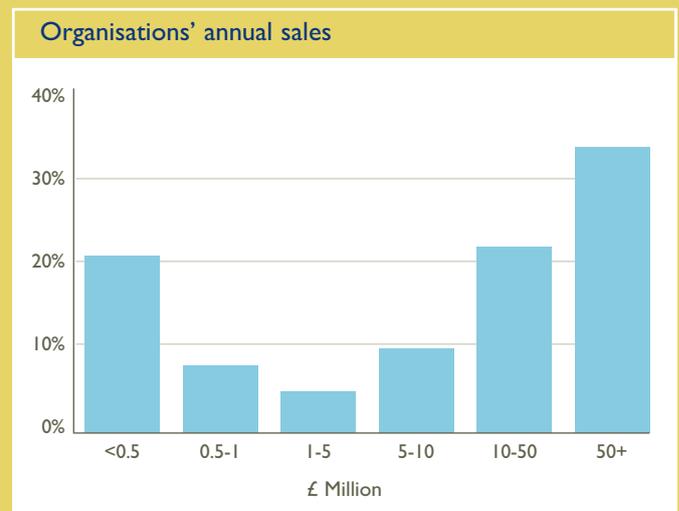
It is also an important survey because it is based on 'honest responses' from organisations in Southern England that completed a secure online questionnaire.

This survey provides a realistic insight into actual fraud, its risk management, and attitudes to fraud within a wide cross section of industry sectors, rather than just fraud as reported through official channels.

Conducted jointly by BDO Stoy Hayward and the University of Portsmouth this study focused on assessing the level of employee fraud and evaluating the basic control procedures in place to reduce the risk of fraud occurring. Almost one third of our 69 respondents had discovered a fraud in the last two years.

A major proportion of our respondent organisations (57 per cent) were service companies but sectors covered included financial services, communications, real estate, leisure, transport & storage, retail, construction, utilities and manufacturing. Most of the respondents (57 per cent) were private limited companies.

The respondents to this survey were from organisations based in Southern England – from Dorset to Kent – but the study group believes the findings are relevant to organisations throughout the UK. (See comparative analysis, Page 7)



Contents

Fraud in 2009 – the key findings	02
Attitudes to Fraud	03
The costs of Fraud	04
Who are the fraudsters?/Why do they do it?	05
Risk Management Measures/Fraud Prevention	06
Combating 21st century fraud/Interesting parallels	07
Top Tips to combat Fraud	08

Fraud in 2009 – the key findings

Fraud is a serious crime... but too few companies recognise that. It can drain the success out of a business or even cripple an organisation completely. By nature, fraud is a secretive crime, yet not enough is being done to seek it out.

A minority of people perpetrate fraud yet the majority of their colleagues unwittingly suffer from it. Fraud can belie good performance by producing poor bottom-line figures (despite long hours of honest employee effort). Targets can be missed, bonuses go begging, jobs that should be secure can be put at risk and the real growth that could underpin investment goes unnoticed.

As businesses battle against recession they will ignore fraud at their peril.

Our Study reveals that:

two thirds of businesses perceive fraud to be a risk in their industry...

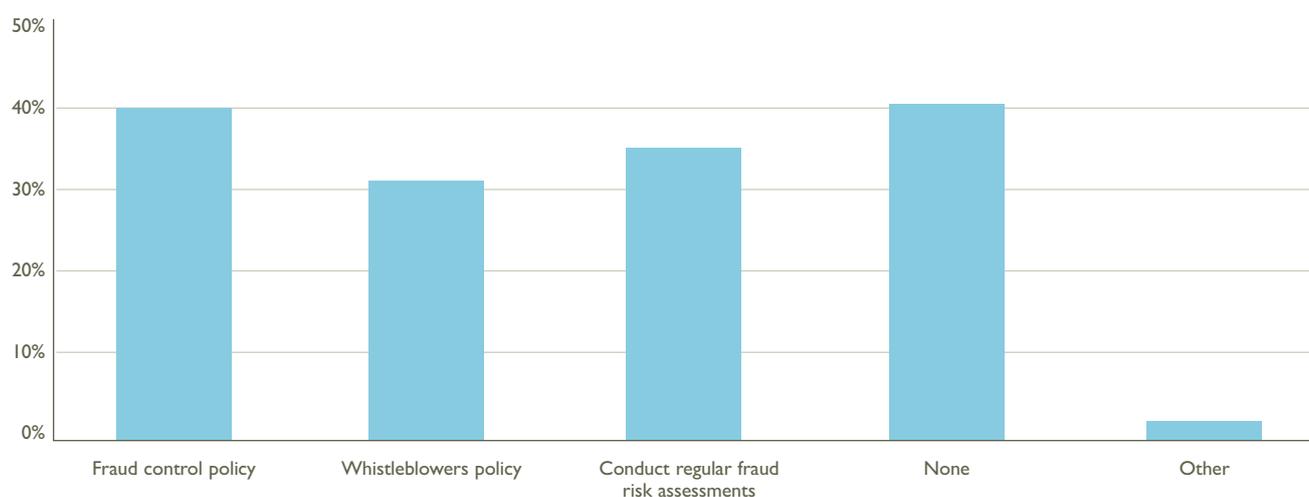
...but, less than one third have a fraud awareness programme or any educational programme relating to the threat of fraud.

and...

nearly 70 per cent believe that fraud will increase in the near term, primarily as a result of the economic downturn...

...but 40 per cent do not have fraud prevention measures in place.

Proportion of organisations with fraud prevention measures



Other significant findings

Almost one third of organisations had discovered a fraud in the last two years.

The profile of offending employees matched very closely the findings of other surveys – primarily male, late-30s and employed by the organisation for less than five years.

Fraud is mainly discovered through internal audit or tip-offs from employees and other stakeholders.

Attitudes to Fraud

Warren Buffet famously said: "It's only when the tide goes out that you learn who's been swimming naked." Whether we are talking about investment risk or exposure to fraud, the phrase is particularly apposite at the moment.

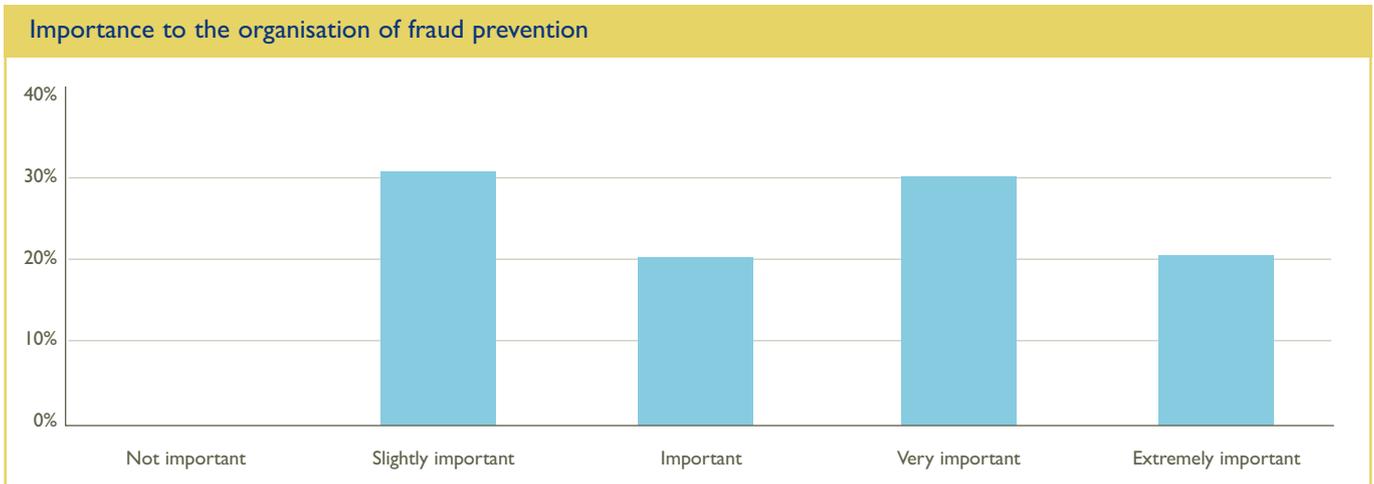
Recessions provide greater opportunities for fraud when internal controls are dismantled in the cause of cutting costs and overheads – opening the door to fraudsters. In a recession the one thing guaranteed to rise is fraud detection, from large scale frauds down to even the fiddling of small expenses to cope with rising living costs.



It's a widely held belief that four out of five businesses suffer an economic fraud every year and around two-thirds of our respondents confirmed that they see fraud as a risk to both the industry in which they operate and their organisation itself. Yet, surprisingly small numbers of respondents had implemented fraud awareness and fraud education programmes.



Our survey revealed some reasons for this paradox. A relatively large proportion of the organisations (31 per cent) viewed fraud prevention as only 'slightly important' and two thirds of respondents had never sought advice on fraud risk. A significant number (14 per cent) believe that fraud is an inherent problem. (See graph, page 5)



The costs of Fraud

The value of reported fraud has increased 189 per cent since 2003 from £411m to £1.19bn in 2008. BDO Stoy Hayward's FraudTrack team has stated that last year reported fraud in the UK was up 14 per cent on 2007.

Actual fraud vastly exceeds this figure. In 2003/04 the Home Office estimated that overall fraud was costing the UK economy £16bn per year¹.

Kay Linnell, Southampton-based BDO Stoy Hayward director of forensic services said: "Our own experience is that our FraudTrack results only show the tip of the fraud iceberg. I am certain that once the recession bites, many more fraudsters will be uncovered."

Between them, our surveyed organisations who reported a fraud incident, each had an average of 1.5 cases of discovered fraud in the last two years. These ranged across a wide spectrum from cash-skimming through to financial statement fraud and asset misappropriation.

The average value of a fraud during the period reviewed 2007-2008 was £74,000 with the frauds ranging in value between £500 and £1m. However, the average total cost to the individual organisations suffering the frauds was £435,000 (including investigation costs and multiple fraud) with the highest individual cost being £4m.

Other studies have shown that up to 50 per cent of a company's turnover can be taken in the worst frauds, and less than 20 per cent of the defrauded sums are recovered.

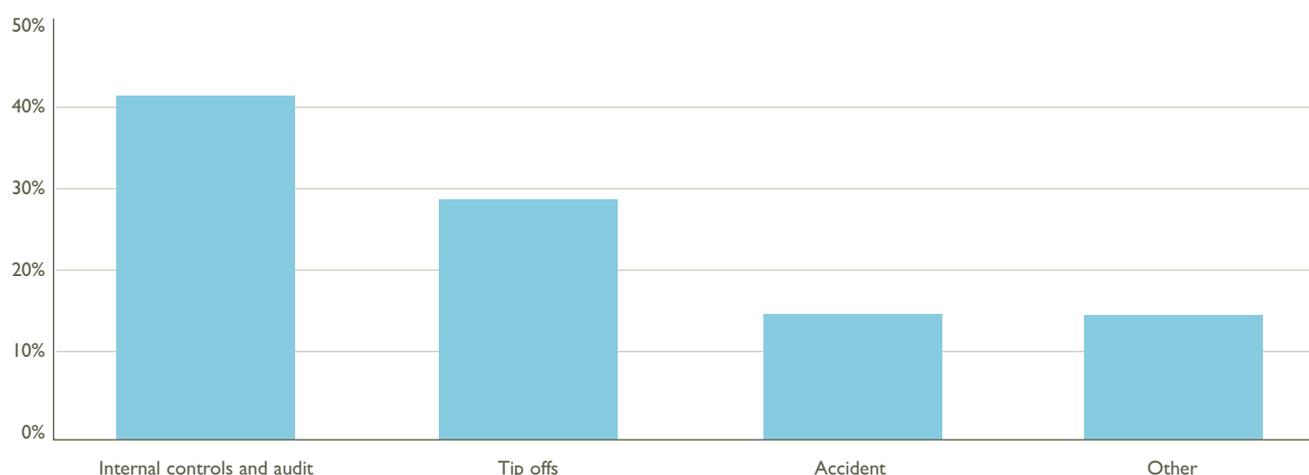
One other interesting 'cost' was thrown up by our study. Only 36 per cent of the fraud cases were reported to the police. One major reason for not doing so was given as the potential damaging 'cost' to the organisation's reputation.

How is Fraud detected?

Our survey found that internal controls and audits (43 per cent) proved the most consistent and effective method of uncovering fraud. However tip-offs accounted for almost one third (29 per cent) of detections. Worryingly, other research has revealed that 40 per cent of staff who discover a fraud do nothing about it, for fear of losing their jobs – a percentage that is hardly likely to fall during recessionary times when jobs are harder to come by.



Fraud discovery methods



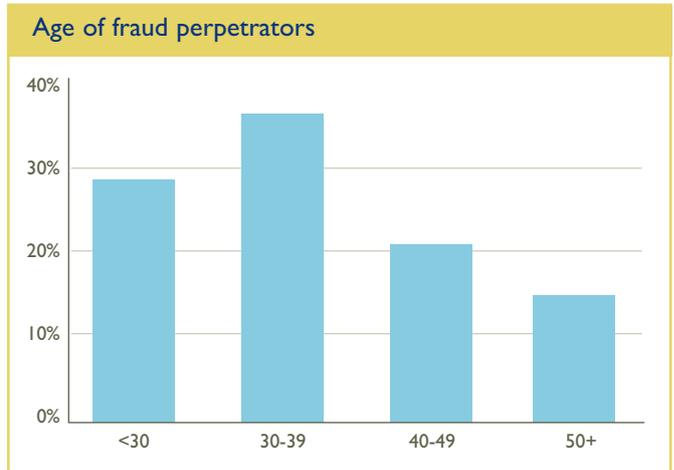
¹Home Office report 30/05, Economic and Social Costs of Crime Against Individuals and Households 2003/2004

Who are the fraudsters?

Our profile of offending employees is very similar to other fraud surveys worldwide. The great majority (86 per cent) were male with an average age of 37 and a length of service with the organisation of less than five years.

Typically, dishonest staff are lacking ethical standards, opportunist and committed to an expensive lifestyle. Fraudsters are often reluctant to take holidays, spend long hours at the office to cover their tracks, personally deal with inappropriate tasks and refuse to delegate.

Other studies have revealed that more than 80 per cent of all fraud is committed by middle management and above, and more than 40 per cent involves finance and accounting staff.



Why do they do it?

The short answer is because they can, and they think they can get away with it.

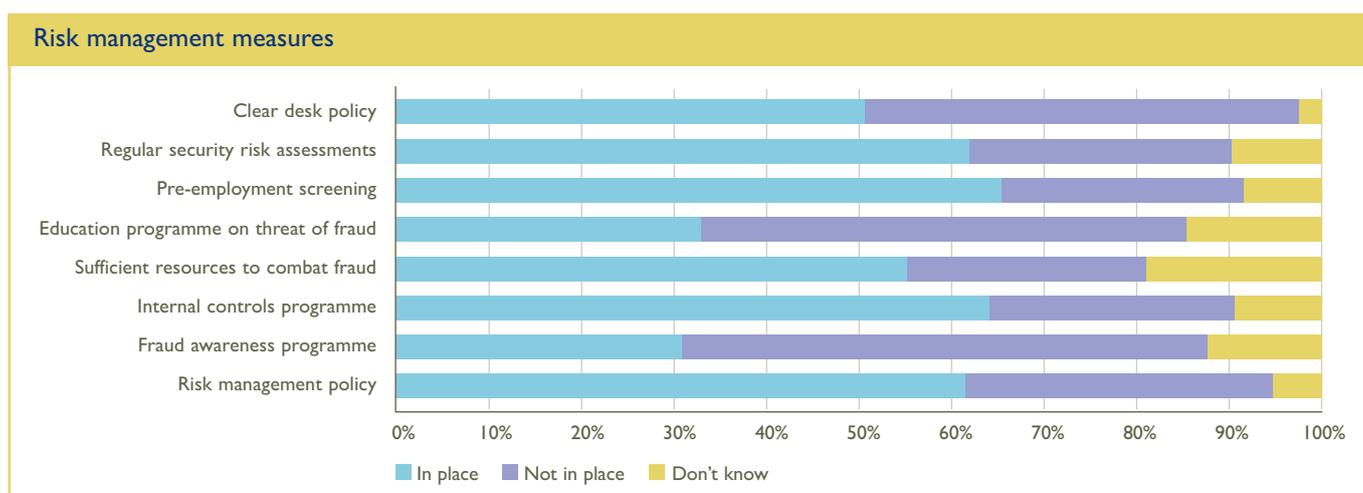
Theory and practice takes the view that three conditions need to be present for fraud to occur: motivation, opportunity and rationalisation (collectively known as The Fraud Triangle). The key motivations revealed by our study were financial pressures and the economic downturn (32 per cent combined total) but there were several others.



Risk Management Measures

Most organisations (60 per cent) have a standard risk management policy and a formalised strategy document in place, along with pre-employment screening for new personnel (66 per cent) and regular risk and threat assessments (62 per cent). However, only a small number

have implemented a fraud awareness programme (30 per cent) or any educational programme on the threat of fraud (34 per cent). A clear desk policy – removing temptations – operates in only 50 per cent of organisations.



Fraud Prevention

Whether a fraud involves asset misappropriation, financial misrepresentation, counterfeiting, money laundering or external collaboration with suppliers, the common factor that allows the fraud is invariably insufficient internal controls.

With almost one third of our respondents reporting fraud incidents, and the current economic climate providing fresh motivation for fraudsters, a cohesive and planned fraud prevention strategy would appear to be a necessity.

Our survey revealed that most organisations use a multiple policy approach to fraud, but 40 per cent have no specific fraud prevention strategies in place.

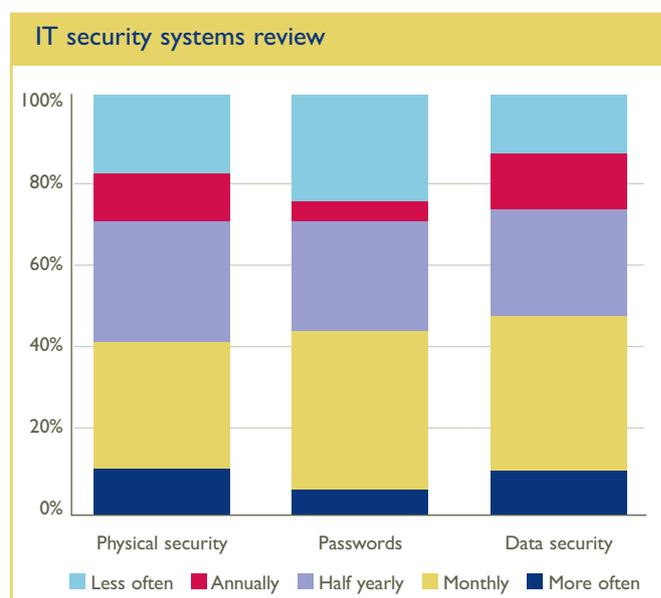
Our respondents also confirmed that they believed the top three factors required to reduce fraud were strong internal controls, organisational culture, and strong top management. Whistleblowing hotlines have not developed in the UK as they have in the USA, but should be given due consideration in light of our Study showing tip-offs as an important factor in uncovering fraud. (See graph, Page 4)



Combating 21st century fraud

The complexity of information technology systems can be the keys to riches for fraudsters. System security is now a major critical factor in any organisation.

Our study showed that more than 40 per cent of organisations review the physical security and passwords of their systems, and nearly half of them their data security, on at least a monthly basis. One in three, however, only reviewed these areas annually or even less often than that.



Interesting parallels

Some interesting parallels with this survey can be found in the recently published annual report on occupational fraud by the Association of Certified Fraud Examiners (ACFE) in the USA².

For instance, across the large number of fraud cases they surveyed nearly 60 per cent of the perpetrators were male, 29 per cent being aged between 31 and 40. Around 40 per cent had been with their respective employers for between one and five years.

Internal audit and tip-offs were major contributors to discovery being 46.2 and 19.4 per cent respectively. Other surveys in the UK, USA and internationally concur with the ACFE and this survey.

Previous studies have noted that up to 50 per cent of companies suffered a fraud annually (now it is reputedly 80 per cent). Another recurring theme is the absolute necessity to conduct full and diligent pre-employment screening.

Perhaps the most important finding of the ACFE, however, was that in companies with specific fraud training programmes the median levels of fraud were reduced by 52 per cent compared with companies without such training. Companies who had instituted an anti-fraud policy reflected a 49 per cent reduction on the same comparative basis.

²Association of Certified Fraud Examiners (2008). Report to the Nation on Occupational Fraud and Abuse

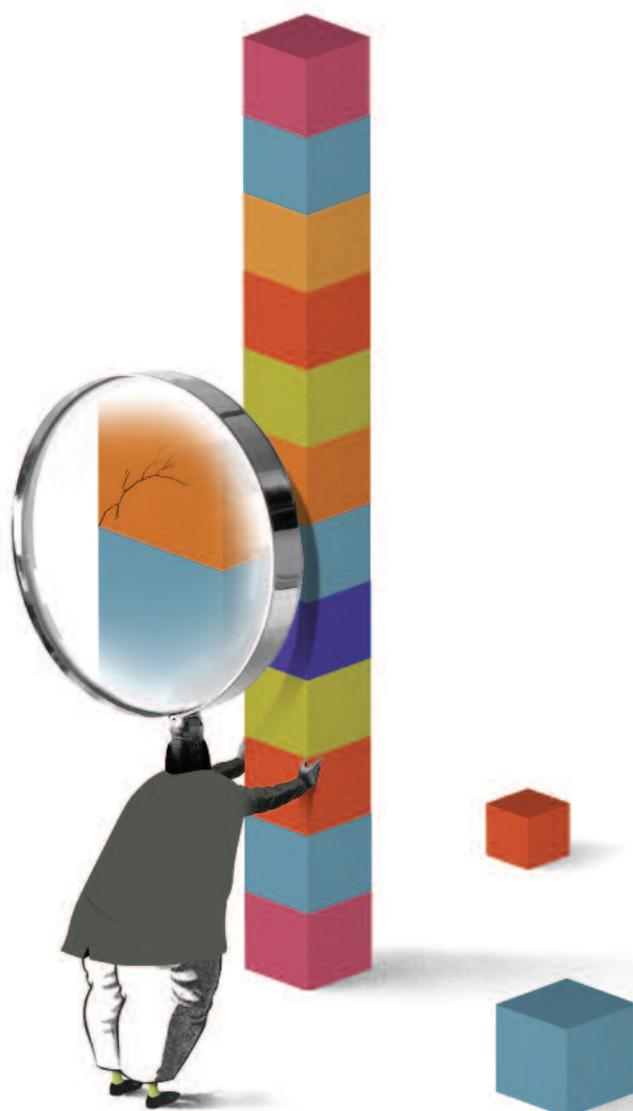
Defeating the enemy within

The troubles of the recession may be all around, but for many companies the enemy will be within – the fraudster employee(s) or suppliers who will line their pockets while watching a business go down.

Taking action against fraud requires commitment, controls and checks. Allocating time and resources to these functions may be difficult as the recession bites, but inaction will only provide ignorance, and ignorance of the true financial facts could lead to insolvency.

10 Tips to help businesses prevent Fraud

- 1 **FOCUS:** Move anti-fraud responsibilities to the 'front line' and embed them in company culture.
- 2 **CONTROL:** Issue clearly understood Compliance and Procedural manuals.
- 3 **MANAGE RISKS:** Develop a Risk Framework. Keep it up to date and work to improve controls in areas of weakness.
- 4 **PUBLICISE:** Communicate the company's anti-fraud policy to all staff and ensure it is regularly updated.
- 5 **STAFF-CHECK:** Ensure proper and full security checks are made before staff or key contract clients and suppliers are taken on.
- 6 **REGULATE:** Introduce and enforce regular Internal Audit reviews of controls designed to combat fraud.
- 7 **TRAIN:** Provide regular training so that staff know how to recognise fraud and the correct procedures to report it.
- 8 **CROSS-CHECK:** Regularly prepare account balances and reconciliations and generally cross-check management information.
- 9 **POLICE:** Investigate and monitor every incidence of suspected fraud and learn from it.
- 10 **PUNISH:** Pursue a vigorous public policy of dealing severely with the perpetrators of fraud.



This report has been produced by BDO Stoy Hayward and the University of Portsmouth.

About BDO Stoy Hayward

BDO Stoy Hayward is the UK Member Firm of BDO International, the world's fifth-largest accountancy network, with more than 600 offices in over 100 countries.

We have a dedicated and highly experienced Forensic Accounting team with a personable approach and the insight to solve the most challenging frauds. We work with management, legal advisers, the police and regulatory authorities to take appropriate action.

Our dedicated team of investigators are highly trained interviewers who can think laterally and get to the truth. We also use the latest technology forensic tools to secure electronic evidence admissible in Court. And after the event, to minimise the chances of reoccurrence, we can bring in our risk specialists to put fraud prevention measures in place.

We have UK offices in Belfast, Birmingham, Bristol, Cambridge, Chelmsford, Epsom, Gatwick, Glasgow, Hatfield, Leeds, London, Manchester, Reading and Southampton.

If you would like further information about this report or our wide range of services, please contact:

Kay Linnell
Forensic Accounting Director
BDO Stoy Hayward LLP
Arcadia House
Maritime Walk
Ocean Village
Southampton SO14 3TL

Email: kay.linnell@bdo.co.uk
Tel: 023 8088 1762

About the University of Portsmouth

The University of Portsmouth is a leading modern university with a strong reputation for teaching and student satisfaction with notable research strengths.

The University delivers postgraduate programmes in Forensic Accounting on campus at Portsmouth and is working towards providing a distance learning version. The University's Business School has been highly rated in the recent Research Assessment Exercise with 70 per cent of the research being ranked as of international standard and on the Research Power Ranking Index the Business School is ranked in the top 35 per cent of higher education institutions, higher than any other Business School on the South Coast.

Richard Trafford
Principal Lecturer
Department of Accounting and Finance
University of Portsmouth
Richmond Building
Portland Street
Portsmouth PO1 3DE

Email: Richard.Trafford@port.ac.uk
Tel: 023 9284 4121

www.bdo.co.uk

www.port.ac.uk



'Audit Team of the Year' 2008
'Tax Team of the Year' 2008
'Corporate Finance Deal of the Year' 2008
'Employer of the Year' 2007

BDO Stoy Hayward LLP operates across the UK with over 3,000 partners and staff. BDO Stoy Hayward LLP is a UK limited liability partnership and the UK Member Firm of BDO International. BDO international is a world-wide network of public accounting firms, called BDO Member Firms. Each BDO Member Firm is an independent legal entity in its own country. The network is coordinated by BDO Global Coordination B.V., incorporated in The Netherlands, with its statutory seat in Eindhoven (trade register registration number 33205251) and with an office at Boulevard de la Woluwe 60, 1200 Brussels, Belgium, where the International Executive Office is located. In the UK the Belfast Firm is operated by a separate Partnership known as BDO Stoy Hayward - Belfast.

BDO Stoy Hayward LLP and BDO Stoy Hayward - Belfast are both authorised and regulated by the Financial Services Authority to conduct investment business.

BDO Stoy Hayward LLP is the Data Controller for any personal data that it holds about you. We may disclose your information, under a confidentiality agreement, to a Data Processor (Shamrock Marketing Ltd). To correct your personal details or if you do not wish us to provide you with information that we believe may be of interest to you, please call Amir Hussain on 023 8088 1751 or email amirhussain@bdo.co.uk

Whilst every care has been taken to ensure the accuracy of this information at the date of publication, the information is intended for general guidance only. Please call us if you would like specific advice on any matter.

Copyright © February 2009. BDO Stoy Hayward LLP. All rights reserved.



This document is printed on 9lives 80, a paper containing 80 per cent recycled fibre and 20 per cent virgin Totally Chlorine Free (TCF) fibre sourced from sustainable forests. 9lives 80 is produced by an ISO 14001 accredited supplier.